Wyckoff in action

(part 2)

by David Weis

In Part 1 of this article (*S&C*, June 1986), we recognized at point #12 (Figure 1) that large operators were accumulating bonds prior to an upswing. The conservative point-and-figure count AB (Figure 2) indicated potential for a move to 63-28. Long positions were recommended for the opening on April 8 with protective sell stops placed beneath the low at #10. The following discussion dissects the volume/price behavior during the subsequent mark-up and distribution phase that evolved over a 13-day period.

April 8. June bonds open at 61-11 before moving to a low of 61-09. Based on an entry price of 61-11, we are risking 7/32nds for a gain of at least 2 1/2 points. After opening lower, prices steadily move higher throughout the session. It is noteworthy to mention here that tick volume has a U-shaped pattern. Tick volume is heavy in the opening 45 minutes and tapers off toward mid-day. From this lull in activity, trading increases until the final rush of volume in the closing hour.

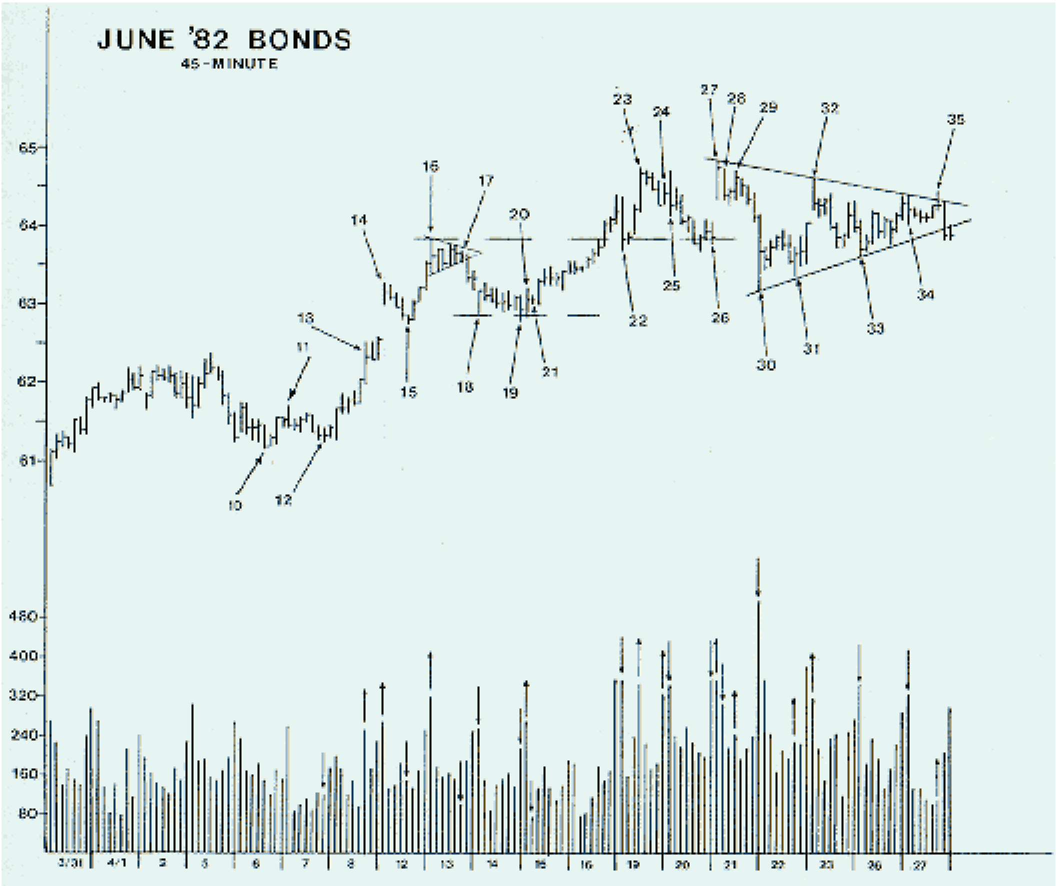
Whenever the volume at mid-day is heavier than on the opening time period, traders should be alert as something significant is usually happening. On April 8, the mid-day tick volume at #13 is heavier than on the opening. This occurs as the bond market breaks through the resistance at 62-12. Demand has overcome supply and the mark-up stage is in full gear. In the last 90 minutes, there is the usual profit taking, but the market refuses to give ground.

April 12. Bonds gap higher to #14. Volume is again heavy, but there is no influx of selling on the subsequent correction. At #15, June bonds trade for 45 minutes in a 4/32nd range suggesting the pressure is off. By the end of the session, prices close on a firm note at 63-17.

April 13. On the opening at #16, June bonds rally to 63-27, thereby fulfilling the conservative point-and-figure objective. Volume on the opening is heavier than at any point in the uptrend and appears climactic. Prices close well off the high as operators are taking profits. This sequence of behavior tell the tape reader to take profits or at least raise sell stops to 63-12 (beneath the low of the opening time period). Prices hold for several hours but the re-test of 63-27 fails to generate another upwave. Volume is not increasing which suggests demand is tired. The market forms a small apex as the forces of supply and demand reach a temporary point of equilibrium.

At #17, the range is narrow and volume contracts. Prices must rally immediately or the sellers will have the upper hand. The tape reader would raise the sell stop to beneath the low at #17. If the trader is aggressive, a break would warrant a short position with buy stops placed at 63-28. The market moves downward off its hinge as supply overcomes demand.

April 15. The market opens lower at #18, but finds support as prices close on the high of the period. Volume is the heaviest since prices topped at #16, suggesting a minor selling climax has occured. There is little or no follow through on the upside as prices stay close to the low of the opening time period. In the last 45 minutes at #19, the bond market penetrates the opening support level but closes well off the


JUNE '82 BONDS
45-MINUTE
65
64
63
62
61
480
400
320
240
160
80
3/31
4/1
2
5
6
7
8
12
13
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26
27

Figure 1:

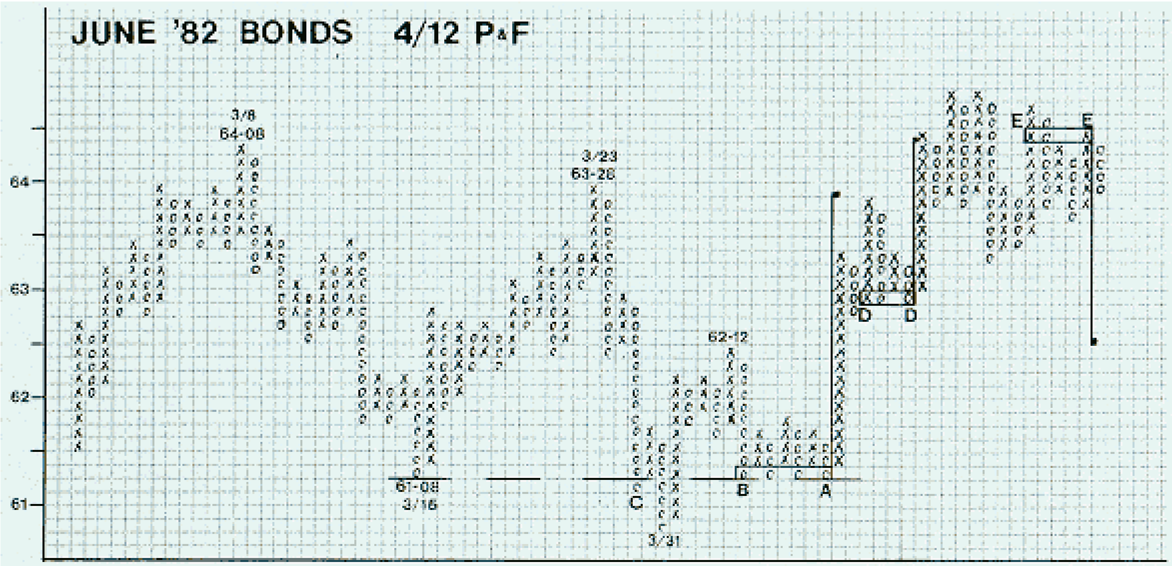
JUNE '82 BONDS 4/12 P&F
3/8
64-08
3/23
63-28
62-12
61-08
3/16
3/31
64
63
62
61
A
B
C
D
D
E
E

Figure 2:

low. If the sellers are in control, the market should open lower on the next day.

April 15. Instead of continuing lower, prices rally on the opening at #20 and volume is heavier than at any point in the correction from #16. Demand has asserted itself again putting bonds in a spring position. This opening rally was met with selling as prices closed off the high. If the next pull-back is on light volume and holds above the low at #19, we will know the market is about to spring upward.

At #21, the market is on the springboard. The behavior is ideal: a narrow range, the lightest volume in days and prices close in mid-range. There is no more selling pressure. (Compare the behavior from #18 to #21 with the price action from #1 to #3.) Any existing short position must be covered at once (netting a half-point gain) and longs established; stops are placed 1/32nd below #19. On the point-and-figure chart, the congestion along the 62-28 line (DD) projects a minimum target of 64-12; the maximum objective is 65-04. From #21, bonds steadily move higher without attracting supply.

April 16. The bond market moves unobtrusively upward until the burst of activity on the closing. Prices reach 64-13, the first point-and-figure objective; volume is heavier than at any time since the low at #1. While there is no evidence of topping action, this behavior is an indication that large operators are unloading part of their long position on strength. Stops on long positions should be raised to 63-15.

April 19. On the opening at #22, bonds drop more than in any time period since the rally from #10; volume is as heavy as on the previous day's closing. This is more evidence that large interests are taking profits.

In the second time period, the selling ceases. Notice that the resistance line across the high at #16 serves as support. With the absence of selling, bonds rush to new highs at #23. Volume expands on the rally and contracts on the pullback. At the close at #24, the buyers make a large effort to push the market higher as indicated by the increase in volume.

April 20. In the first 45 minutes, at #25, bonds open higher, encounter resistance against the previous day's high and reverse downward. The heavy volume on the decline adds to the bearish picture that is forming. The tape reader would take profits on long positions. A short position also could be established with buy stops placed 1/32nd above the high at #25.

Bonds decline into the area of previous support at #22 and on top of the previous resistance line. The lack of volume on this decline warns the tape reader to take profits on any shorts at the close. The heavy volume on the close suggests that other traders have spotted the weakness in bonds and are selling the market. Since prices gave little ground in the last 45 minutes, we can assume the operators are supporting the market in order to build a larger short position. Another test of the high is possible.

April 21. The market opens strong and makes a new high at #27. If the uptrend is to remain intact, there must be followthrough. Instead, at #28, bonds sell off and volume remains heavy. This is bearish behavior and the light volume rally at #29 indicators demand is tiring.

April 23. The market makes another surge toward the highs on the opening at #32, however, it is met by new selling as prices end the time period on the low.

Looking across the chart from #29, bonds have persistently met supply around the 64-24 level (#23, #25,

#27, #28). For all the effort to move higher, the rally to #27 exceeded the previous high by only 3/32nds. This represents shortening of the upward movement and an upthrust (the opposite of a spring). The heavy selling at #28 quickly negated the move to new highs.

With this bearish behavior and the tired rally at #29, a short position is warranted. Buy stops are placed 2/32nds above the high at #27. The bond market begins to slide lower until the collapse in the last time period at #30. *Given the bearish behavior which preceded it,* the fall at #30 is a major sign of weakness and not a washout. It indicates that sellers have gained the upper hand.

April 22. Bonds open unchanged and make a lackluster attempt to rally. On the pull-back to #31, there is no evidence of selling pressure; therefore, the tape reader takes profits on the short position. Bonds rally on the close as the sellers have backed off.

April 23. The market makes another surge toward the highs on the opening at #32, however, it is met by new selling as prices end the time period on the low. By the end of the day, all of the opening gains are erased as the bonds close unchanged. The sign of weakness still looms heavily on the tape reader's mind, but there is no evidence that the downtrend is ready to resume.

April 26. Bonds open lower at #33 as the sellers make a strong effort to break the market. However, the minor uptrend line drawn across #30 and #31 checks the decline. Prices rally away from the danger point and push higher on the close. The closing rally stops against a downtrend line drawn across the tops at #27 and #32. It is obvious now that an apex is forming but on a larger scale than experienced at #17.

April 27. Again the market opens lower at #34 on heavy volume. Prices manage to close off the low of this time period as demand is still present. During the next three time periods, the price ranges narrow and volume dries up. The bond market is in position to rally out of the apex. The force of the demand will tell whether or not buyers have gained the upper hand in this struggle.

At #35, the bond market moves slightly above the apex and the previous day's high. Volume remains light and prices close unchanged for the time period. The tape reader recognized that demand is exhausted. Counting only a portion of the top along the 64-12 line (EE on the point-and-figure chart), the reader projects a conservative objective of 62-16. Short positions are established and stops placed 1/32nd above the high at #32.

On the next time period, volume is heavy as bonds fall beneath the low of the day. The distribution phase is complete. June bonds declined to 62-15 on May 4.

From the beginning of the upwave (#10) to the conclusion of the distribution phase (#35), we have concentrated only on volume/price behavior. During this time, other traders worried over money supply, CPI and conflicting stories about budget talks. Also, Henry Kaufman released one of his pronouncements about the future of interest rates. We considered none of this information. The trader who isolates himself from everything but the market and takes the time to study what the market is saying about itself can duplicate the trading techniques developed 80 years ago by Richard Wyckoff.

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